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## AMENDING A CONTRACT CONTRARY TO ITS OWN PROVISIONS

### *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd*<sup>1</sup>

In this case, the Court of Appeal held that a written contract was varied by conduct despite a clause precluding variation by conduct. The result of this ruling is that the standard clause requiring any variation to be in writing signed by both parties is unenforceable. More generally, it seems that English law will not enforce a term which imposes formalities on the variation of a contract.

In reaching this conclusion, the Court settled a conflict of authority. There were two inconsistent unreported Court of Appeal decisions on whether a clause prescribing a manner of variation was enforceable: *United Bank Ltd v Asif* held it was;<sup>2</sup> *World Online Telecom Ltd v I-Way Ltd* held it was not.<sup>3</sup> Strangely, these cases were two years apart and both heard by Sedley LJ, who changed his mind in the latter without mentioning the former. Faced with this inconsistency of precedent, the Court of Appeal in our case (consisting of Lord Justice Moore-Bick V-P, Beatson and Underhill LJ) applied the first exception to the rule in *Young v Bristol Aeroplane Co Ltd*:<sup>4</sup> it considered itself bound by neither of the inconsistent decisions and elected to follow *World Online*.

The enforceability of the variation clause was actually a side-issue in the present case. TRW manufactured electric steering systems. Under a long-term supply agreement, TRW was to purchase, exclusively from Globe Motors, certain components for its steering system. The components which the exclusivity clause covered were defined in the agreement. This definition was quite complicated as it allowed for changes to the specifications and technological developments. In the event, TRW purchased components from a third party. Globe Motors considered these components to be covered by the exclusivity clause and sued TRW for breach of contract. The main issue in the case was a matter of construction: Did the components bought from the third party fall within the exclusivity clause? In the Commercial Court, Judge Mackie QC found that they did. Applying conventional principles of contractual interpretation, the Court of Appeal found that the components were not under the exclusivity clause and dismissed the claim. But as Lord Justice Moore-Bick V-P said, the interpretation of the agreement was not 'of general importance'.<sup>5</sup>

What was of general importance was a secondary issue: whether another party was added to the supply agreement and hence could sue under it. This party was Porto, a Portuguese subsidiary of Globe Motors. The trial judge found that the original parties, Globe Motors and TRW, had agreed by conduct to join Porto. This was because the original parties had treated Porto as a party over a long period. The Court of Appeal agreed. But it was unclear whether such

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<sup>1</sup> [2016] EWCA Civ 396.

<sup>2</sup> CA, 11 February 2000, [17]-[18] (Thorpe LJ approvingly quoting Sedley LJ in the application for permission to appeal).

<sup>3</sup> [2002] EWCA Civ 413, [6]-[12] (Sedley LJ), [17] (Schiemann LJ).

<sup>4</sup> [1944] KB 718 (CA), 729 (Lord Greene MR).

<sup>5</sup> [2016] EWCA Civ 396, [118].

agreement by conduct prevailed over Article 6.3, which provided that the supply agreement could ‘only be amended by a written document which (i) specifically refers to the provision of this Agreement to be amended and (ii) is signed by both Parties.’

As it happened, the Court of Appeal’s finding that TRW did not breach the supply agreement by buying components from a third party (the main issue) made the status of Porto irrelevant. There being no breach, Porto’s right of action under the agreement was valueless. Disappointingly, then, the most interesting point in the case – the enforceability of the agreement by conduct in view of Article 6.3 – did not fall to be decided. Nevertheless, given the conflict of authority, the Court felt bound to settle the matter. All three judges expressed a reasoned view on this point, though technically in *obiter*. They concurred in holding that freedom of contract entailed that the parties’ agreement by conduct must be given effect notwithstanding Article 6.3. That is to say, the supply agreement was varied by conduct so as to add Porto as a party. The rest of this note is an evaluation of this conclusion.

There is no doubt that the Court’s decision has the weight of authority behind it. Besides *World Online* (the later inconsistent decision), *Spring Finance Ltd v HS Real Company LLC*,<sup>6</sup> *Energy Venture Partners Ltd v Malabu Oil and Gas Ltd*<sup>7</sup> and *Virulite LLC v Virulite Distribution Ltd*,<sup>8</sup> contain *dicta* suggesting a clause against informal variation will be ineffective. The authors of *Chitty on Contracts* echo this view.<sup>9</sup> In fact, with the notable exception of *Asif* (the earlier inconsistent decision), there appears to be unanimity: restrictions on variation are ineffective. Even Sedley LJ in *Asif* later changed his mind. The reasons adduced in the various judgments in support of this position boil down to one argument: freedom of contract.

The argument from freedom of contract is that parties can at any time agree whatever terms they wish, subject to consideration, and (generally) there is no formality. They can do so in writing, orally, by conduct and even by implication. Since the parties can make a new contract without formality, they can, *a fortiori*, amend a contract or waive compliance with any clause of it without formality (not least the clause requiring writing). The point is that the parties cannot by a present agreement destroy their own freedom to agree something different in the future. Lord Justice Moore-Bick V-P found an analogy in the supremacy of Parliament: just as a sovereign legislature cannot bind its successors, so can parties (taken together) not bind themselves. In short, freedom of contract in this context means that parties cannot agree *not to agree*.

While this argument is formidable in theory, the result is surprising. Practitioners will be surprised to learn that a standard clause, almost ubiquitous in professionally-drafted agreements, is void (or at least ineffective). Parties will be surprised to know that, whereas Parliament has fettered the freedom of contract with formalities (such as writing for the sale of land<sup>10</sup>), they cannot do so themselves.

The result is also paradoxical. Freedom of contract is usually invoked to justify the enforcement of the terms of the contract. Here the same freedom has *prevented* the enforcement of a term in favour of the very thing which the parties expressly agreed to prohibit. The rejoinder, of course, is that the parties’ earlier agreement (stipulating written variation) had to yield to the parties’ later agreement (to add a party). Thus the freedom of contract is said to be

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<sup>6</sup> [2011] EWHC 57 (Comm), [53] (Judge Mackie QC, who also sat at first instance in the present proceedings).

<sup>7</sup> [2013] EWHC 2118 (Comm), [273] (Gloster LJ).

<sup>8</sup> [2014] EWHC 366 (QB); [2015] 1 All ER (Comm) 204, [55] (Stuart-Smith J).

<sup>9</sup> HG Beale (ed.), *Chitty on Contracts*, 32nd edn (London, 2015), vol. 1, [22-045] fn 196.

<sup>10</sup> Law of Property (Miscellaneous Provisions) Act 1989, s 2.

reinforced; for it is the freedom to agree at any time and without formality. But this is a circular justification. The conclusion is in the premise: if we assume that the parties can agree at any time without formality, it is tautological to say that the parties are not bound by formalities. The question is: is this premise correct, or should it be possible for parties to stipulate a formality? Is freedom of contract really incompatible with formalities?

I can see two objections to the admittedly persuasive consensus that freedom of contract renders self-imposed formalities on variation ineffective. First, the wayward clause in question (Article 6.3) does not actually rob the parties of their power to agree something else in the future. It only prescribes a mode of doing so. It is conceded that a clause excluding any variation whatsoever is void for repugnancy to the freedom of contract. But the clause under consideration does no such thing. It only tells parties how to exercise their freedom. If we revisit the supremacy of Parliament, it will be seen that the exercise of legislative power is subject to numerous formalities (for example readings and, pertinently, writing). Nobody considers these formalities repugnant to the supremacy of the institution. True, Parliament can abolish the formalities – but to do so it must comply with them.<sup>11</sup> So it is with the parties to our supply agreement. They can dispense with any clause, but must comply with the formalities.

It is not clear therefore that freedom of contract is compromised by formalities. Even if it is, it is only constrained to a small degree: the minor hassle of putting the variation in writing. This is surely no hardship for legally-represented businesses. If we weigh this hassle against the advantages of the formality, namely the prevention of costly disputes arising from spurious allegations of oral variations, it seems like a compromise worth making. Indeed, it is a compromise commercial parties make all the time. It may be questioned whether freedom of contract is really served by insisting on the absence of formality, when the parties have not lost any substantive freedom.

The second objection is that freedom of contract does not prevent waiver of rights. It is true that parties can form contracts without formality under the general law, but it is not clear why parties cannot waive this freedom just as they can waive other freedoms available to them under the law. To be sure, a clause that disallows variation absolutely is void, but why should a clause which merely imposes a formality on variation be void? If I can waive a right not to be touched under the law of tort, why should I not be able to waive the power to vary contracts without formality? The only answer, it seems, is that freedom of contract inherently means no formality; but this, as we have seen, begs the question. Why can freedom of contract not tolerate formalities when even the constitutional tenet of parliamentary supremacy does?

And yet, the argument from freedom of contract remains strong. If the parties have indisputably agreed on a price variation and have acted accordingly for a long time, it would be pedantic, and harsh, for English law to ignore the variation.

Furthermore, as Nicholas McBride has argued, relying on the formality clause may be tantamount to using the written agreement as an instrument of fraud. The formality is thus ineffective – not because of freedom of contract, but to prevent a party who has pocketed consideration for an oral variation from reneging on his side of the bargain.

It is suggested by way of compromise that an informal variation may override a stipulated formality, but subject to a high evidential threshold; perhaps even a rebuttable presumption that the parties did not vary the agreement in disregard of the formality. This approach would not

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<sup>11</sup> See Owen Dixon, "The Law and the Constitution" [1951] LQR 590, 601, quoted approvingly by Lord Steyn in *R (Jackson) v Attorney General* [2005] UKHL 56; [2006] 1 AC 262, 296.

offend the freedom of contract and at the same time protect parties from spurious claims – an important commercial interest.

There is some tentative judicial support for such compromise: Beatson LJ (in the present case) and Judge Mackie QC (at first instance and in *Spring Finance*) said the evidence of the informal agreement had to be ‘clear’ or ‘strong’.<sup>12</sup> Lord Justice Moore-Bick V-P highlighted the evidential difficulties that would be encountered by a party seeking to overcome a stipulated formality: ‘if only because it is likely to raise in an acute form the question whether parties who are said to have varied the contract otherwise than in the prescribed manner really intended to do so’.<sup>13</sup> Underhill LJ commented to the same effect.<sup>14</sup> Unfortunately, Stuart-Smith J in *Virulite* and Judge Keyser QC in *McKay v Centurion Credit Resources LLC*<sup>15</sup> rejected any suggestion that a higher standard of proof should apply. Gloster LJ appeared to take the same view in *Energy Venture Partners*.<sup>16</sup> Since an informal agreement must be proved on the balance of probabilities irrespective of a formality clause, this latter approach would really mean that a clause imposing a formality on variation is totally meaningless.

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<sup>12</sup> Respectively: [2016] EWCA Civ 396, [109]; [2014] EWHC 3718 (Comm), [486]; [2011] EWHC 57 (Comm), [53].

<sup>13</sup> [2016] EWCA Civ 396, [120].

<sup>14</sup> *Ibid*, [117].

<sup>15</sup> [2011] EWHC 3198 (QB), [56]; [2014] EWHC 366 (QB), [60].

<sup>16</sup> [2013] EWHC 2118 (Comm), [273].

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